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APPLICATION OF

SOUTHWESTERN VIRGINIA GAS COMPANY

CASE NO. PUE970765

For an expedited increase in rates

REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER

May 1, 1998

On September 24, 1997, Southwestern Virginia Gas Company ("Southwestern" or "the Company") filed an application for an expedited increase in rates for gas service designed to increase the Company's total annual operating revenues by \$251,427, or approximately 2.95%. By order dated October 23, 1997, the Commission authorized the Company to place its proposed rates into effect on an interim basis, subject to refund with interest, for bills rendered on and after November 30, 1997. The Commission's Order of October 23 also established a procedural schedule and assigned the case to a Hearing Examiner.

On March 16, 1998, Southwestern filed a Request to Lower Rates for bills rendered on and after March 31, 1998, to reflect the Staff's recommended annual increase in this case of \$99,696. The Company's request to lower its interim rates was granted by Hearing Examiner's Ruling dated March 17, 1998.

A public hearing on the application was convened on April 8, 1998. Counsel appearing were: Richard D. Gary, Esquire, counsel for the Company and C. Meade Browder, Jr., Esquire, counsel for the Commission's Staff. Because the Company and the Staff were in agreement on all but two issues regarding the cost of service study to be performed in the Company's next case, the testimonies of all witnesses were stipulated into the record without cross-examination. A transcript of the hearing is filed with this Report.

SUMMARY OF THE RECORD

Southwestern's application for an increase in annual revenues of \$251,427 is based on a test period ending June 30, 1997.¹ In direct testimony filed on March 5, 1998, the Staff recommended that Southwestern's requested annual increase be reduced from \$251,427 to \$96,233.² Part of the difference in revenue requirement between the Company and the Staff

¹ Exhibit RJP-4, at 2, 4.

² Exhibit GAT-7, at 10, Schedule II.

related to the Staff's recommendation to lower the authorized return on equity from 11.3%, as authorized in Southwestern's prior case, to 10.6%.³

While the Staff adopted the Company's revenue apportionment percentages, the Staff provided recommendations regarding apportionment of lower than requested revenue requirements and customer charges.

Should the Commission approve revenue which differs from that proposed by the Company, the revenue should be apportioned to customer classes in the same percentages as proposed by the Company. The customer charges should be increased as proposed by the Company and any remaining revenue should be distributed to the incremental rate blocks in a manner similar to the Company's proposed rate design. If the approved increase is lower than the additional revenue collected from each class's proposed customer charges, the customer charge should be increased as proposed by the Company and usage rates should be reduced proportionally across the rate blocks.⁴

The Staff also recommended that in its next case Southwestern be directed to divide Schedule B into separate service schedules for small general service customers and for firm industrial customers.⁵ In addition, the Staff recommended that concurrent with the division of Schedule B, the Company should remove any non-jurisdictional customers from the jurisdictional cost of service study and separate air conditioning customers currently served under Rate Schedule D.⁶ On March 20, 1998, the Staff revised its overall annual revenue requirement increase recommendation to \$99,696.⁷

No other parties filed protests or intervened in this case.

On March 18, 1998, Southwestern filed limited rebuttal testimony requesting that in its next general rate filing the Company not be required (i) to remove non-jurisdictional customers, and (ii) to present air conditioning service as a separate class.⁸ At hearing, counsel for the Company verified that Southwestern now accepted all of Staff's revenue and rate recommendations as to this case. Nonetheless, the two issues addressed in the Company's rebuttal testimony regarding the cost of service study to be filed in the Company's next general rate case continue to be contested.⁹

³ Exhibit JRB-9, at 1, 11, 12, Schedule 3, Schedule 12.

⁴ Exhibit RMH-10, at 7.

⁵ *Id.* at 3, 4, 6.

⁶ *Id.* at 6.

⁷ Exhibit GAT-8, at 2, Statement II.

⁸ Exhibit RJP-6.

⁹ Gary, Transcript at 7-8.

At the hearing Southwestern submitted the prepared direct and prepared rebuttal testimonies of Mr. Ralph J. Pruitt.¹⁰ Mr. Pruitt also sponsored the Company's cost of service study.¹¹ The Staff offered the testimony of three witnesses. Ms. Genevieve A. Toler presented Staff's revenue requirement calculations and recommended accounting adjustments in her prepared direct and prepared revised direct testimonies.¹² Mr. John R. Ballsrud provided Staff's cost of capital recommendations,¹³ and Ms. Rosemary M. Henderson supplied Staff's analysis of the Company's revenue apportionment and rate design proposal.¹⁴ The testimonies of all witnesses were entered into the record without cross-examination.

DISCUSSION

Based on the Company's application and based upon a review of the record, I find that agreement between Southwestern and the Staff offers a reasonable and just resolution to all revenue requirement, cost of capital, revenue apportionment, and rate design issues. In essence, Southwestern has agreed to all of the Staff's recommendations concerning the resolution of this case. I agree with the Company that the Staff's recommendations concerning Southwestern's revenue requirement, cost of capital, revenue apportionment, and rate design for this case should be adopted.

The only issues that are in controversy and warrant further discussion concern the cost of service study which the Staff recommends the Company be required to file with its next general rate case. In Southwestern's prior rate case, Case No. PUE950019, the Commission ordered certain changes to be made to cost of service studies filed by the Company in future rate cases.

(14) The Company shall perform a customer cost of service study in future cases to continue to move customer charges toward the actual cost of service.

(15) Southwestern shall segregate the commercial and industrial firm services in Rate Schedule B and collect data supporting further restructuring as part of its next rate application.¹⁵

In compliance with the Commission's Order from Case No. PUE950019, Southwestern filed a cost of service study in this proceeding that segregated commercial and industrial firm service customers.¹⁶ Nonetheless, because this case was filed as an expedited proceeding, the Company maintained the same revenue apportionment and rate design as approved in its prior case.¹⁷ The Staff concurred and recommended that Southwestern be directed in its next general

¹⁰ Exhibit RJP-4, Exhibit RJP-6.

¹¹ Exhibit RJP-5.

¹² Exhibit GAT-7, Exhibit GAT-8.

¹³ Exhibit JRB-9.

¹⁴ Exhibit RMH-10.

¹⁵ 1996 S.C.C. Ann. Rep. 263, 265.

¹⁶ Exhibit RJP-5.

¹⁷ Exhibit RJP-4, at 2.

rate filing to propose separate service schedules for commercial and industrial customers based upon customers' usage characteristics and the type of facilities required to serve them.¹⁸ The Staff further recommended the removal of non-jurisdictional customers and the separation of air conditioning customers in future cost of service studies to be filed by Southwestern.

Concurrent with the division of Schedule B, the Company should remove the non-jurisdictional customers from the jurisdictional cost of service and rate base. At the same time, the Company should reconfigure its cost of service study to present the air conditioning service, Schedule D, as a separate class. This service to residential and commercial/industrial customers is presently included in the cost analysis for Schedules A and B.¹⁹

As indicated above, Southwestern does not agree with either of the Staff's recommendations for future cost of service studies. Each of these recommendations is addressed separately below.

Removal of Non-Jurisdictional Customers

Section 56-235.2 A of the Virginia Code limits the determination of just and reasonable rates to the revenues and costs "incurred by the public utility in serving customers within the jurisdiction of the Commission" Thus, the Commission's Rate Case Rules require the filing of a jurisdictional cost of service study.²⁰ While noting that the Commission's Rules do not require absolute perfection in filings, the Commission has held that an application from a utility that failed to provide a jurisdictional cost of service study was materially incomplete and could not be deemed filed for purposes of measuring rate suspension periods.²¹ Consequently, whenever possible a utility should eliminate non-jurisdictional customers from its jurisdictional cost of service.

In this case, the Company maintains that directing the removal of non-jurisdictional customers, which amount to 1% or less of sales and customers, is not cost justified.²² Company witness Pruitt recommends that Southwestern not be required to separate non-jurisdictional customers in future cost of service studies in the absence of a significant change in the sales or numbers of non-jurisdictional customers.²³

The Staff has recognized in both the Company's prior case and in this case that separation of non-jurisdictional customers is not cost justified because those customers amount

¹⁸ Exhibit RMH-10, at 4, 6.

¹⁹ *Id.* at 6.

²⁰ *See*, Rules Governing Utility Rate Increase Applications and Annual Informational Filings, Rule Nos. I(5) & I(7).

²¹ *Application of Virginia-American Water Company For a general increase in rates*, Case No. PUE950003, 1995 S.C.C. Ann. Rep. 339.

²² Exhibit RJP-6, at 1-2.

²³ *Id.* at 2.

to about 1% of sales and total number of customers.²⁴ Nonetheless, the Staff recommends that the elimination of non-jurisdictional customers be made in conjunction with any cost of service study that segregates commercial and industrial customers currently served under Rate Schedule B.²⁵ In anticipation of such a modification to its rate schedules the Company now tracks usage data for the customers served under Rate Schedule B.²⁶ A breakdown of this information provided by Staff witness Henderson shows that non-jurisdictional customers account for almost 5%, or 41 of the 873 customers served under Rate Schedule B.²⁷ One of these non-jurisdictional customers is among the 19 customers with monthly usage over 5,000 Ccf.²⁸ Therefore, failure to eliminate non-jurisdictional customers could have a material impact on the rates to be derived by separating commercial and industrial customers currently served under Rate Schedule B into two new and different rate schedules.

Moreover, the Staff's breakdown of usage by customers currently served under Rate Schedule B also demonstrates that preparation of a jurisdictional cost of service study should not be overly burdensome to the Company. Of the twenty-seven allocation factors employed by Southwestern in the cost of service study it supplied in this case, most could be adapted to eliminate non-jurisdictional customers because they are derived either from the allocation or assignment of specifically designated accounts, or from sales or customer counts. In addition, the demonstrated ability to identify individual non-jurisdictional customers should facilitate the direct assignment and development of other allocation factors.

Therefore, I am of the opinion that the record fails to support the Company's claim that elimination of non-jurisdictional customers from future cost of service studies is not cost justified. Already, the Company is undertaking the steps to modify its rate schedules to provide separate and distinct rates for commercial and industrial customers currently served under Rate Schedule B. These steps also should enable the Company to eliminate non-jurisdictional customers from its cost of service.

Presentation of Air Conditioning Service as a Separate Class

A cost of service study provides the Commission with indications of the degree to which "each class covers its true cost of the service provided to it."²⁹ In this regard, the Commission's goal is to move the return provided by each customer class toward the overall return or parity.³⁰ Consistent with this goal, the Staff recommends that "the Company should continue the movement toward parity for all of its classes. It should also continue to file a cost of service study with each application in order to demonstrate that its revenue allocation and rate design are appropriately accomplishing this goal."³¹

²⁴ Exhibit RMH-10, at 2.

²⁵ *Id.* at 6.

²⁶ *Id.* at 5.

²⁷ *Id.* at 6.

²⁸ *Id.*

²⁹ *Commonwealth of Virginia, ex rel. State Corporation Commission v. Virginia Electric and Power Company*, Case No. PUE870014, 1988 S.C.C. Ann. Rep. 270, 278.

³⁰ *Id.*

³¹ Exhibit RMH-10, at 5.

The cost of service study filed by Southwestern in this case was divided into the following service classifications: (i) residential; (ii) commercial; (iii) industrial; (iv) interruptible; and (v) transportation.³² However, the Company utilizes the following rate schedules: (i) Rate Schedule A (residential); (ii) Rate Schedule B (commercial and industrial); (iii) Rate Schedule C (interruptible); (iv) Rate Schedule D (air conditioning); and (v) Rate Schedule T (transportation).³³ In other words, Southwestern currently provides service to air conditioning customers under a separate rate schedule, but does not show those customers as a separate customer class in its cost of service study. Consequently, there is no way to determine the extent to which these customers cover their cost of the service or whether these customers are moving toward or away from parity.

Company witness Pruitt defends omitting a separate classification for air conditioning service in its cost of service study on the grounds that Schedule D customers (13 out of 4614) and sales (3,756 Mcf out of 2,028,899 Mcf) are insignificant when compared with total company customers and sales.³⁴ Also, Rate Schedule D is used only for five months of the year with customers being served under Rate Schedules A or B for the remainder of the year.³⁵ Furthermore, the Company is not required to install special plant to provide service to air conditioning customers.³⁶

Unlike the separation of non-jurisdictional customers, discussed above, there is nothing in the record to indicate whether it would be cost justified for the Company to prepare a cost of service study with a separate classification for air conditioning service. On the other hand, the Company's defense for omitting a separate classification for air conditioning service also raises the question of whether there is sufficient justification for a separate rate schedule for air conditioning service. Either way, however, Southwestern must shoulder the responsibility of providing evidence of the reasonableness of its customer classifications and its rate structures. Therefore, rather than recommend that the Company be ordered to provide a cost of service study in its next general rate case showing air conditioning service as a separate and distinct classification, I recommend that the Commission order Southwestern to provide evidence and support for both the existence and rates of Rate Schedule D.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the agreement between the Company and the Staff, and on the evidence received in this case, I find that:

- (1) The use of a test year ending June 30, 1997, is proper in this proceeding;
- (2) The Company's test year operating revenues, after all adjustments, were \$8,363,135;

³² Exhibit RJP-5.

³³ Exhibit RJP-4, Schedule 33.

³⁴ Exhibit RJP-6, at 2.

³⁵ *Id.*

³⁶ *Id.*

(3) The Company's test year operating revenue deductions, after all adjustments, were \$7,929,990;

(4) The Company's test year net operating income and adjusted net operating income, after all adjustments were \$433,145 and \$419,632, respectively;

(5) The Company's current rates produced a return on adjusted rate base of 8.10% and a return on equity of 8.38%;

(6) The Company's current cost of equity is within a range of 10.10% - 11.10%, and the Company's rates should be established based on the 10.60% midpoint of the equity range;

(7) The Company's overall cost of capital, using the midpoint of the equity range found reasonable herein and using a capital structure as of June 30, 1997, is 9.335%;

(8) The Company's adjusted test year rate base is \$5,181,294;

(9) The Company's application requesting an annual increase in revenues of \$251,427 is unjust and unreasonable because it will generate a return on rate base greater than 9.335%;

(10) The Company requires \$99,696 in additional gross annual revenues to earn a 9.335% return on rate base;

(11) The Company's proposed revenue allocation methodology, as supplemented by the Staff for lower than requested revenue requirements and for customer charges, is just and reasonable;

(12) The Company's revised interim rates, which became effective for bills rendered on and after March 31, 1998, should be approved as permanent rates;

(13) The Company should be required to refund, with interest, all revenues collected under its initial interim rates in excess of the amount found just and reasonable herein;

(14) In its next general rate case, Southwestern should modify its Rate Schedule B to provide separate service schedules for small general service (or commercial) customers and for firm industrial customers;

(15) In its next general rate case, Southwestern should eliminate non-jurisdictional customers from its class cost of service study; and

(16) In its next general rate case, Southwestern should provide evidence regarding the continued need for Rate Schedule D and the reasonableness of rates charged for air conditioning service.

In accordance with the above findings, ***I RECOMMEND*** that the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report;
2. ***GRANTS*** the Company an increase in gross annual revenues of \$99,696; and
3. ***DIRECTS*** the prompt refund of all amounts collected under interim rates in excess of the rate increase found just and reasonable herein.

COMMENTS

The parties are advised that, pursuant to Rule 5:15(e), any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within fifteen (15) days from the date of this Report. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

Alexander F. Skirpan, Jr.
Hearing Examiner